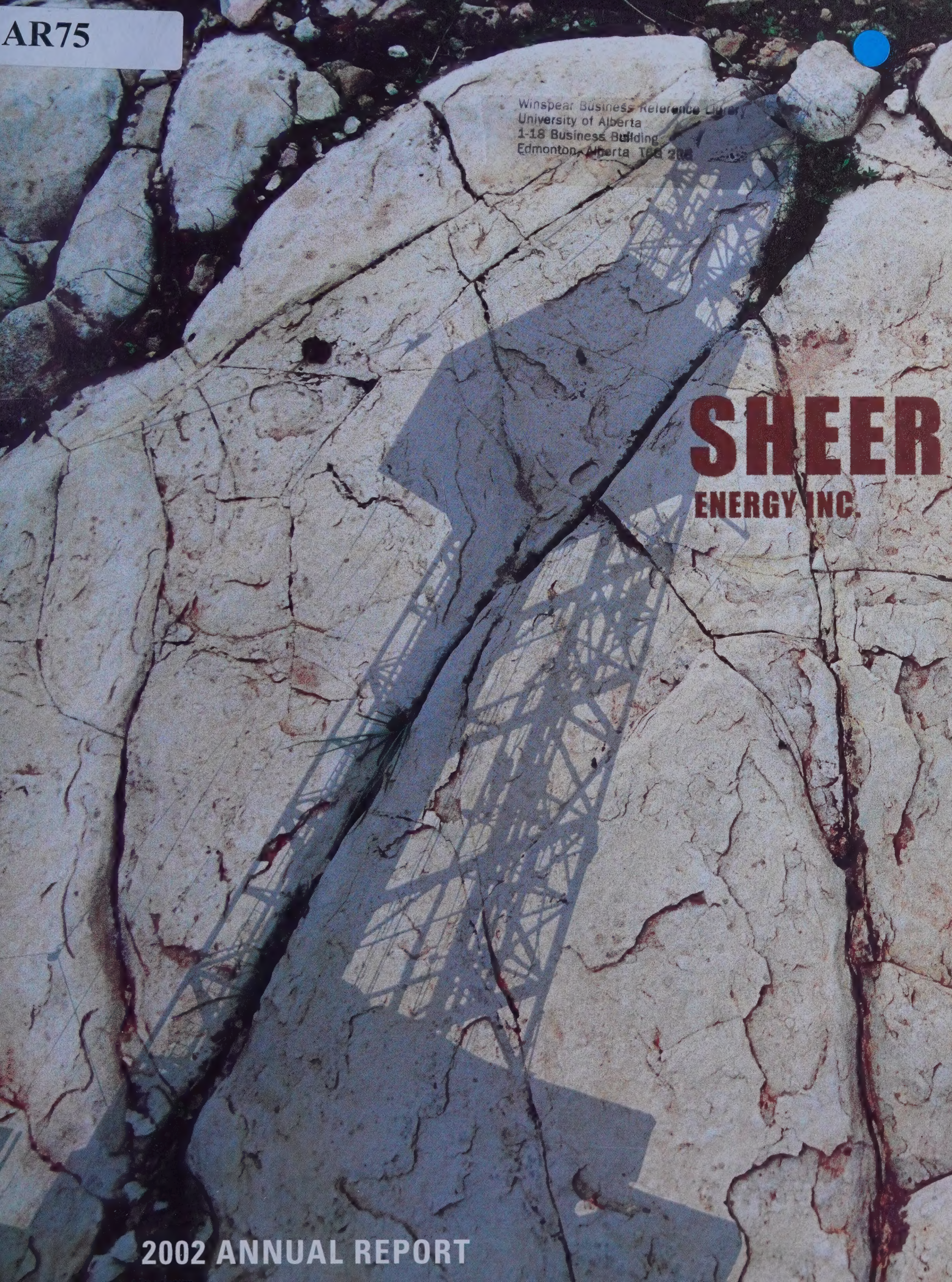

SHEER
ENERGY INC.

2002 ANNUAL REPORT

CORPORATE PROFILE

Sheer Energy Inc. is a publicly traded oil and gas exploration and production company. Approximately 82% of the Company's revenues are derived from gas production with approximately 45% of all gas revenue being generated from the South Edson Gas Unit.

During the fiscal year, the Company announced that its wholly owned subsidiary, Sheer Energy (Cyprus) Limited, had entered into a Service Contract for the development of the Masjed-I-Suleyman oil field in Iran. Sheer Energy (Cyprus) Limited is the operator of the project and holds a 49% interest therein.

FINANCIAL SUMMARY

Years ended December 31		2002		2001
Total revenue (net of royalties)	$	556,053	$	762,244
EBITDA		23,917		368,288
Cash flow from operations		(22,181)		254,696
Cash flow from operations per share	$	0.00	$	0.05
Earnings (loss)		(91,934)		80,938
Earnings (loss) per share	$	(0.02)	$	0.02
Capital expenditures		625,214		350,302
Total assets	$	2,584,229	$	1,685,594
Common shares outstanding at December 31		6,057,863		4,837,863

ANNUAL MEETING

The Annual General Meeting of the Shareholders of Sheer Energy Inc. is to be held at 3:00 p.m. on Friday, June 20, 2003 in the "Hamilton" room, Bow Valley Square, 205-5th Avenue S.W., Calgary, Alberta.

PRESIDENT'S MESSAGE

The May 28, 2002 signing of the Masjed-I-Suleyman (MIS) contract was a milestone in the corporate existence of Sheer Energy Inc., as outlined later in this report.

Canadian operations and results for 2002 were negatively impacted by relatively low natural gas prices which persisted through most of the year. It is encouraging to note that the current fiscal year has seen strong natural gas pricing which a number of analysts predict will remain at much higher levels than 2002 due to supply issues and the need to replenish storage volumes which were drawn down over the winter heating season.

The Company has been financing its MIS participation primarily through the use of proceeds from a $435,000.00 private placement and the sale of an undeveloped land holding in Alberta subsequent to the fiscal year end. The long anticipated short term financing which was negotiated in June of 2002 has not received the necessary regulatory approvals due to unforeseen circumstances and has recently been withdrawn. A replacement for this financing is presently being documented. Obviously a secure source of long term project financing is needed and your management is pursuing several avenues in this regard. We will keep the shareholders informed as to our progress.

On behalf of the management and Board of Directors, I would like to express our sincere appreciation to Mr. Julio Poscente for his contribution to the corporation over the last six years. His wise counsel and sage advice will be missed. Mr. Poscente is retiring at the next Annual General Meeting and will not be standing for re-election.

We are pleased to advise that Mr. Drew Burgess C.A. has agreed to stand for election at the next Annual General Meeting. We believe Mr. Burgess will be a valuable addition to our Board and will bring experience both in accounting and financial management as well as the management of publicly traded corporations.

Your management is very satisfied with the progress and results to date of the MIS reservoir study and simulation and looks forward to reporting on our progress on all fronts in the ensuing fiscal year.

Once again, we would like to thank our shareholders for their patience and support and the Board of Directors for their dedication.

May 20, 2003
Calgary, Alberta

T.D. Lawrence
President and C.E.O.

MASJED-I-SULEYMAN FIELD OPERATIONS REVIEW

Sheer Energy (Cyprus) Limited signed the Masjed-I-Suleyman Service Contract with the National Iranian Oil Company (NIOC) on May 28, 2002. The signing ceremony, held in the conference hall of the National Iranian Oil Company in the city of Masjed-I-Suleyman, was attended by numerous NIOC officers and senior employees, members of the Iranian Parliament, the Iranian Deputy Petroleum Minister, the Canadian Ambassador and the Canadian Vice Consul in Iran, in addition to officers and directors of our Iranian partner, Naftgaran Engineering Services Co. (NESCO).

This ceremony culminated over three years of data gathering, discussions and lengthy negotiations in Iran and ratified the second "Buy-Back Contract" awarded to a Canadian company, after the offshore Balal field had been assigned to Bow Valley Energy Ltd. in April, 1999.

As reported more extensively in our 2001 Annual Report, the Masjed-I-Suleyman project calls for the re-development of the field with an expected improvement of production by an incremental 20,000 barrels of oil per day. This will be accomplished through the re-completion of existing shut-in oil wells, drilling of two vertical and eight horizontal wells, installation of production and water handling facilities and the use of high lift pumps.

Following the official signing of the contract, Exploration Consultant Limited (ECL) of Calgary, the independent consulting firm which was awarded the comprehensive reservoir study contract, commenced gathering of all petrophysical, geological and engineering data available on the MIS and nearby fields. In conjunction with the work of ECL, Sheer's officers conducted geological field work on outcrops of the Asmari formation, the main oil producing zone in the MIS field, and also inspected several shut-in wells, existing road grid and potential locations for the production facilities on the north flank of the field where the majority of new drilling and re-completion work is expected to occur. The comprehensive geological/engineering evaluation of the MIS field is well under way and is expected to be completed by the end of August. A detailed petrophysical evaluation of the 22 wells logged in the late 1950's and early 1960's has been completed; logs were normalized and re-calibrated to modern standards and provided an excellent correlation between wells in the Asmari formation. Porosity, permeability and fracture component parameters were analyzed and a complete set of structural, isopach and production maps has been produced. Fracture orientation and density were measured in field outcrops and several structural cross-sections have been prepared for the MIS field and nearby areas. Production data from the 121 wells which produced oil at MIS over the years was plotted and analyzed together with pressure data.

In addition, the absolute location of selected wells on NIOC maps was checked against modern GPS surveys conducted by Sheer on 32 wells; despite a consistent shift in coordinates, the correlation was very good. Volumetric and material balance calculations to establish the original oil in place have been made and show a good correlation.

All this data will now be entered into a geological/engineering computer simulation program which will determine the remaining recoverable oil and will show areas of optimum remaining oil reserves thus allowing Sheer to select the best locations for vertical and horizontal wells. The computer model will also give guidelines on the optimal production rates for the reservoir.

In September, 2002, Mr. Charles Cook, a founding shareholder and director of Sheer Energy Inc. was appointed Project Manager of the Masjed-I-Suleyman Development Project and moved to Tehran. Mr. Cook has extensive experience in the oil business and in Iranian operations having worked in Tehran before as

Managing Director of Travis Chemical Iran Ltd. Mr. Cook will work closely with our partner, NESCO, and officers of NIOC to ensure that the project will be completed in time and on budget.

Renovation work on two existing buildings next to the NIOC offices in Masjed-I-Suleyman has been completed. These buildings will house the field office for Sheer and NESCO and provide accommodation for the contractors who will be involved in drilling operations and production facilities construction as contemplated under the Service Agreement.

Tender documents for drilling operations at MIS were prepared in late 2002 and advertised in industry and business papers. Over twenty five companies expressed an interest in the project and seventeen purchased the tender documents. Based on the technical evaluation of proposals, six drilling contractors have now been short-listed and six service companies have been approved for various drilling related services. A further high-grading of drilling and service companies will be done subsequent to equipment inspection. It is expected that final selection of the contractors will be completed by mid summer based on technical and financial considerations. Drilling operations at MIS will probably commence in early 2004.

MASJED-I-SULEYMAN FIELD PARAMETERS AND FUTURE POTENTIAL

The MIS field was the first "giant field" discovered in the Middle East and still holds great potential for future development and production. A review of history and past activities in the field was presented in great detail last year and shareholders are referred to our 2001 annual report for that kind of information. In our 2002 annual report we are pleased to enclose a list of major field parameters taken from reported NIOC data.

Year of discovery	**1908**
Anticline size at water/oil contact	30 km x 7 km
Initial total productive area	28,400 acres (11,493 hectares)
Estimated initial oil in place	6,580 million barrels
Production to date	1,126 million barrels
Peak daily production	145,000 bopd (maximum 24 wells producing)
Producing formation	Asmari limestone (Oligocene-Miocene age)
Original gross pay thickness	2,450 feet (746 m)
Current net pay thickness	210-450 feet (64-137 m)
Matrix porosity	6-12%
Fracture porosity	Very extensive
Water saturation	36%
Oil gravity	Average 40° API
Gas-Oil Ratio	220 SCF/STB original; 680 SCF/STB current
Initial oil pressure	1,078 psi
Current flowing pressure	430-560 psi
Total wells drilled into Asmari Fm.	240
Total wells placed on production	121
Average completion depth	2,830 feet (863 m)
Wells currently producing	10-12
Current total field production	4,100-4,500 bopd
Expected daily production/new vertical well	500-1,000 bopd
Expected daily production/new horizontal well	2,000-2,500 bopd

CANADIAN OPERATIONS REVIEW

The Company's net average daily production for 2002, expressed in barrels of oil equivalent per day (boe/d), was 58.3 boe/d versus 79 boe/d in the previous year. The decrease in production was mostly due to the sale of the Pine Creek property effective January 1, 2002, a prolonged plant turn-around at the South Edson Unit during the second quarter and natural productivity declines. The daily production, expressed in boe/d, is based on the industry standard conversion factor of 6 Mcf equaling one barrel of oil.

An evaluation of the remaining recoverable reserves and the net present value attributable to five of Sheer's unitized properties was completed by Fekete Associates Inc. at December 31, 2002. An independent appraisal of Sheer's properties operated by Signalta Resources Limited was conducted by Matsalla Consulting (1981) Ltd. This latter report is based on the January 1, 2003, evaluation by DeGolyer and MacNaughton of the proved and probable reserves of properties operated by Signalta Resources Limited.

Fekete Associates Inc. has assigned a 10% net discounted present value of $1,666,000 to the proven plus probable reserves at December 31, 2002 versus a value of $1,880,700 at December 31, 2001, which still included the Pine Creek property sold in January, 2002 for $165,000.

Remaining recoverable reserves, net to Sheer after royalties, as evaluated by Fekete amount to 568,000 Mcf of natural gas and 33,900 barrels of oil and natural gas liquids. This compares favourably to reserves in the previous year of 620,000 Mcf of natural gas and 37,400 barrels of oil and natural gas liquids, exclusive of reserves assigned to the Pine Creek property.

Appraisal by Matsalla Consulting of the approximately 214 gas and oil wells operated by Signalta Resources indicates that the remaining recoverable reserves, net after royalties, for Sheer's interest in such producing wells are in the order of 320,260 Mcf of natural gas and 4,665 barrels of oil and natural gas liquids, having an estimated net present value of approximately $650,000 at a 10% discount rate.

Total remaining recoverable reserves from all of Sheer's properties would therefore be approximately 888,260 Mcf of natural gas and 38,565 barrels of oil and natural gas liquids, with a combined net present value at a 10% discount of approximately $2,316,000. This is equivalent to total remaining recoverable reserves of 186,608 boe at December 31, 2001, after production of 21,293 boe during the year.

The following table summarizes the net present value and the remaining recoverable reserves, net after royalties, of all the combined Canadian properties owned by Sheer.

CALCULATED NET PRESENT VALUE		REMAINING RESERVES
@ 0%	$3,933,010	Gas (Mcf) 888,260
@ 10%	$2,316,101	Oil (bbls) 21,829
@ 12%	$2,135,321	NGL (bbls) 16,736
@ 15%	$1,917,772	
@ 18%	$1,739,923	

Following is a brief description of the units evaluated by Fekete Associates Inc.

SOUTH EDSON GAS UNIT NO. 1

Sheer has a 8.9688% working interest in the South Edson Gas Unit No. 1 located west of Edmonton. The Unit covers 45,120 gross acres of land and produces gas from the Elkton-Shunda formations. Three wells are currently on production and five wells are shut-in or suspended. Probable additional reserves were assigned to a proposed drilling location at 11-26-50-17 W5M.

ConocoPhillips, the Unit operator, is considering drilling of additional infill locations in the latter part of 2003.

Proved producing reserves, net to Sheer after royalties, amount to 312,000 Mcf of natural gas and 6,000 barrels of natural gas liquids. Net probable additional reserves are 221 Mcf of natural gas and 5,000 barrels of natural gas liquids.

The 10% discounted cash flow value assigned to proved producing reserves is $829,860 and the probable, unrisked reserves would add another $384,970 to the value of the property for a total value of $1,214,830. This value does not take into consideration the potential infill locations which may be proposed by ConocoPhillips.

HARMATTAN EAST UNIT NO. 1

The Company holds a 1.014525% working interest in oil production and a 0.13331% working interest in natural gas production from the Harmattan East No.1 Petroleum Unit and a 0.13331% working interest in the natural gas production from the Harmattan East No. 1 Natural Gas Unit.

The Petroleum Unit commenced production in 1961 and currently consists of twenty two producing wells, fourteen water injectors and one CO_2 injector. The Natural Gas Unit has twenty two producing wells and three gas storage wells. Remaining recoverable reserves, net to Sheer after royalties, amount to 35,000 Mcf of natural gas and 15,000 barrels of oil and natural gas liquids. The 10% discounted cash flow assigned to the proved producing reserves is $391,300.

MINOR PROPERTIES

Sheer holds minor working interests in three other oil units, namely Cynthia Cardium Unit No. 4, Snipe Lake Beaverhill Lake Unit No. 1 and Wainright Unit No. 6. The Company's working interest in these three units range from 0.076% (Snipe Lake and Wainright) to 0.32% (Cynthia).

Combined 10% discounted cash flow value for proved producing reserves, net to Sheer, is approximately $60,000.

Apache Canada, the operator for the Snipe lake Unit, commenced a comprehensive program of infill horizontal drilling and re-completions in the latter part of 2002 – early 2003. To the end of April 2003, ten horizontal wells, three re-completions and one water injection well have been proposed. Initial production rates from the first horizontal wells drilled are quite significant.

Reserves and cash flow from these wells have not been included in the Fekete report.

VISION, CORE BUSINESS AND STRATEGY

Sheer's core business at this time remains its Canadian oil and gas production base. However, as we move forward with the Masjed-I-Suleyman re-development project, the Canadian production will become less important, although it will continue to provide a strong base for our corporate existence. Our strategy is to become an increasingly recognized Canadian based participant in the Iranian oil industry and we view the MIS project as only the first step in achieving that objective. Apart from the potential to take the MIS redevelopment beyond its existing targeted production, management feels that success in this pool may allow the company to utilize the knowledge gained to apply similar technologies to other similar fields in the Zagros fold belt of Iran. The MIS project was chosen for its low geological and production risk and it should be noted that the field is presently producing approximately 4,500 barrels of oil per day of high quality crude oil which does not form part of the re-development contract.

The MIS contract by its structure is a long term investment with three more years of capital expenditures required before first production will be achieved and a further three years will be required to achieve the repayment of capital investment and the payment of the remuneration fee. The proven nature of the reserves and the compounded rate of return allowed under the remuneration fee lends itself to long term project debt financing.

To the extent that Canadian dollars are invested in this project, there is a degree of currency risk. However, we anticipate that project financing will be done in U.S. dollars and, with repayment being made from crude oil sales in U.S. dollars, most of the currency risk will be eliminated. Risk also exists with respect to crude oil prices, however, our project economics were calculated at a price of $15.00 U.S. per barrel and the project returns would not be affected at all unless crude oil reached a level of approximately $11.00 per barrel. Below that level project rates of return would begin to be reduced.

Iran is situated in an area of the Middle East which has seen more than its share of turmoil over the past few years. In spite of this, the government in Iran has remained stable and reforms are being implemented. While a political crisis is always a possibility, it is our view that political reform will continue and that positive changes will continue to evolve.

HISTORICAL ANALYSIS

Production volumes are based on the daily production which resulted in revenues to the account of Sheer Energy Inc. The total net production to the account of the Company in 2002 was 21,280 BOE (based on the conversion of 6MCF of gas equalling one barrel of liquid). Total net production for the 2001 fiscal year was 28,864 BOE. Production volumes were reduced due to normal production declines and the January 2002 sale of the Pine Creek Unit interests.

12 months ended December 31,	2002		2001	
	$	$/BOE	$	$/BOE
Oil and Gas Revenue	594,667	27.94	1,042,812	36.13
Royalties net of ARTC	(106,468)	(5.00)	(283,659)	(9.83)
Interest & Consulting Fees	67,854	3.19	3,091	0.11
Total Net Revenue	556,053	26.13	762,244	26.41
Amortization	109,753	5.16	159,558	5.53
Operating Costs	216,314	10.16	156,219	5.41
General and Administration	315,822	14.84	237,737	8.24
Interest	21,159	1.00	34,204	1.19
Income Taxes	(31,061)	(1.46)	75,589	2.62
Future Site Restoration	16,000	0.75	18,000	0.62
Net Earnings (Loss)	(91,934)	(4.32)	80,937	2.80

Revenue per barrel of oil equivalent (BOE) was down approximately 23% from the previous year. At the same time production volumes were reduced approximately 26%.

Royalties net of ARTC decreased by 49% from $9.83 in the 2001 year to $5.00 in the 2002 fiscal year primarily as a result of lower product prices which tend to increase the Alberta Royalty Tax Credit (ARTC).

Operating costs increased by 47% from $5.41 per BOE to $10.16 per BOE in 2002 due primarily to an adjustment to processing costs at South Edson for a prior period.

General and Administrative costs increased by 67% from $8.24 per BOE in 2001 to $14.84 in 2002 due primarily to increased consulting fees paid to companies controlled by two of the Directors and full time Officers of the Company.

Interest expenses decreased 16% from $1.19 per BOE in 2001 to $1.00 per BOE in 2002 due to reduced overall debt levels. Debt levels and interest costs will continue to decline and most of the Company's debt, which was incurred to assist with property acquisitions, will be retired in the latter half of the fiscal year 2003.

The Company incurred a loss of $4.32 per BOE in 2002 compared to earnings of $2.80 per BOE in 2001, primarily due to reduced sales volumes and prices combined with increased General and Administrative costs, reduced Income Taxes and reduced Amortization resulting from lower production volumes.

MANAGEMENT'S REPORT

To the Shareholders of Sheer Energy Inc.:

Management is responsible for the preparation of the Financial Statements in accordance with generally accepted accounting principles in Canada. The financial and operating information presented elsewhere in this annual report is consistent with that shown in the financial statements.

Management maintains systems of internal controls to provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced in a timely manner.

Hudson & Company LLP, an independent firm of Chartered Accountants, has been engaged to examine the financial statements. Their report is presented with the financial statements. The Audit Committee of the Board of Directors has reviewed the financial statements with management and the external auditors. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Kevin Maguire

Terrance D. Lawrence
President

Kevin Maguire
Treasurer

AUDITORS' REPORT

To the Shareholders of Sheer Energy Inc.:

We have audited the consolidated balance sheets of Sheer Energy Inc. as at December 31, 2002 and 2001 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Hudson & Company

Calgary, Alberta
May 20, 2003

HUDSON & COMPANY LLP
Chartered Accountants

DECEMBER 31	2002	2001
ASSETS		
CURRENT		
Accounts receivable	629,629	$ 79,885
Income taxes receivable	–	2,364
Prepaid expenses	20,711	18,185
	650,340	100,434
CAPITAL ASSETS (Note 5)	1,933,889	1,585,160
	$ 2,584,229	$ 1,685,594
LIABILITIES		
CURRENT		
Bank indebtedness (Note 6)	$ 73,264	$ 155,055
Accounts payable	861,449	101,559
Income taxes payable	24,000	–
Bank loans (Note 7)	207,527	379,415
	1,166,240	636,029
FUTURE INCOME TAXES (Note 10)	133,065	189,065
FUTURE SITE RESTORATION COSTS	69,126	54,858
	1,368,431	879,952
SHARE CAPITAL AND DEFICIT		
SHARE CAPITAL (Note 8)	1,358,801	856,711
DEFICIT	(143,003)	(51,069)
	1,215,798	805,642
	$ 2,584,229	$ 1,685,594

FUTURE OPERATIONS (Note 2)

Approved on behalf of the Board

Terrance D. Lawrence, Director

Kevin Maguire, Director

Kevin Maguire

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

YEARS ENDED DECEMBER 31		2002		2001
REVENUE				
Petroleum and natural gas sales	$	594,667	$	1,042,812
Royalties, net of Alberta Royalty Tax Credit		(106,468)		(283,659)
Interest income		8,715		3,091
Consulting fees		59,139		–
		556,053		762,244
EXPENSES				
General and administration (Note 9)		315,822		229,002
Operating costs		216,314		164,953
Amortization and depletion		109,753		159,558
Interest		21,159		34,204
Provision for site restoration		16,000		18,000
		679,048		605,717
EARNINGS (LOSS) BEFORE INCOME TAXES		(122,995)		156,527
INCOME TAX EXPENSE (RECOVERY)				
Current		24,939		79,389
Future		(56,000)		(3,800)
		(31,061)		75,589
NET EARNINGS (LOSS)		(91,934)		80,938
DEFICIT, beginning of year		(51,069)		(132,007)
DEFICIT, end of year	$	(143,003)	$	(51,069)
BASIC AND DILUTED EARNINGS (LOSS) PER SHARE (Note 11)	$	(0.02)	$	0.02

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31		2002		2001
CASH FLOWS FROM OPERATING ACTIVITIES				
Net earnings (loss)	$	(91,934)	$	80,938
Items not affecting cash:				
Amortization and depletion		109,753		159,558
Future income taxes		(56,000)		(3,800)
Provision for site restoration		16,000		18,000
		(22,181)		254,696
Change in non-cash working capital items				
Accounts receivable		(549,744)		216,724
Income taxes		26,364		(67,180)
Prepaid expenses		(2,526)		952
Accounts payable		214,918		(5,196)
Bank loans		(171,888)		(208,027)
		(505,057)		191,969
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of capital assets		(625,214)		(350,302)
Proceeds on disposal of capital assets		165,000		–
Payables related to capital assets		544,972		–
		84,758		(350,302)
CASH FLOWS FROM FINANCING ACTIVITY				
Issuance of share capital		502,090		–
INCREASE (DECREASE) IN CASH		81,791		(158,333)
CASH (BANK INDEBTEDNESS), beginning of year		(155,055)		3,278
BANK INDEBTEDNESS, end of year	$	(73,264)	$	(155,055)
Other information				
Interest paid	$	21,159	$	39,558
Income taxes paid		19,043		151,910

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

1. GENERAL

Sheer Energy Inc. was formed, under the laws of the Province of Alberta, at the close of business on December 31, 1998 pursuant to an amalgamation agreement between Sheer Energy Inc. and its wholly owned subsidiary, Krystal Energy Limited. The business of the Company is the exploration, acquisition, development and production of petroleum and natural gas reserves through joint venture arrangements in Western Canada and the Middle East.

2. FUTURE OPERATIONS

As at December 31, 2002, the Company had a working capital deficit of $515,900 (2001 – $535,595) and incurred a loss of $91,934. The Company currently does not have the ability to meet other financial obligations as outlined in Note 12, however, the Company is continuing to explore all financing alternatives. Also, there is $438,260 included in accounts receivable which is due from the joint venture partner in Iran relating to their share of expenditures on this project. The Company's ability to complete the project in Iran will depend upon their joint venture partner's ability to fund their share of project costs. Subsequent to year end, the Company has recovered $262,674 of the amount due from its joint venture partner in the Iran project.

These financial statements have been prepared on a going concern basis which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The ability of the Company to continue as a going concern is dependent upon its ability to attain profitable operations and generate funds therefrom and on borrowings from shareholders, related parties and third parties sufficient to meet current and future obligations.

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

3. CHANGE IN ACCOUNTING POLICY

Effective January 1, 2002, the Company prospectively adopted the new accounting standards with respect to accounting for stock options. The Company's stock-based compensation plans for employees do not involve the direct award of stock, or call for the settlement in cash or other assets. As a result the Company has the option to apply either the intrinsic value based or the fair value based method of accounting for stock-based compensation awards granted to employees. For awards of stock options to non-employees, the Company is required to expense the fair value of each award. To date, the Company has not awarded stock options to non-employees.

The Company has elected to apply the intrinsic value based method of accounting for employee stock options and accordingly, no compensation costs have been recognized in the financial statements. In accordance with the Company's share option plans, these options have an exercise price equal to the market price at the date of grant.

4. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared using the historical cost basis in accordance with accounting principles generally accepted in Canada. These financial statements have, in management's opinion, been properly prepared within the framework of the accounting policies summarized below.

Consolidation

The consolidated financial statements include the accounts of Sheer Energy Inc. and its wholly owned subsidiary Sheer Energy (Cyprus) Limited. The subsidiary was incorporated as a limited liability company in the Republic of Cyprus on July 27, 2000. Significant intercompany balances and transactions have been eliminated.

Foreign exchange

The accounts of the foreign subsidiary were translated to Canadian dollars using the temporal method. Under this method, monetary items are translated at the exchange rate in effect at the year end, non-monetary items are translated at the historical rate of exchange and revenues and expenses are translated at the average rate for the year. Exchange gains or losses on translation were expensed in the current year.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. The amounts recorded for depletion, and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of changes in such estimates in future years could be material.

Investment in joint venture

Substantially all of the Company's oil and gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

Cash

Cash and equivalents consist of funds on deposit in foreign banks and the balance of a demand revolving operating loan available by way of account overdraft.

Capital assets

The Company follows the full cost method of accounting for oil and gas operations, whereby all costs of exploring for and developing oil and gas properties and related reserves are capitalized. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, and geological and geophysical expenses and related overhead.

Capitalized costs, excluding costs relating to unproven properties, are depleted using the unit-of-production method based on estimated proven reserves of oil and gas before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content. The foreign cost centre is considered to be in the preproduction stage and accordingly all capitalized costs have been excluded from the depletion calculation.

The Company applies a "ceiling test" to capitalized costs in its two costs centres (foreign and domestic) to ensure that the net costs capitalized do not exceed the estimated future net revenues from the production of its proven reserves, plus the cost of undeveloped lands, less impairment. Future net revenues are calculated at year end prices and include an allowance for estimated future general and administrative expenses, interest expense, income taxes and capital expenditures.

Gains or losses on the disposition of oil and gas properties are not ordinarily recognized except under circumstances which result in a change in the depletion rate of 20% or more. Subsequent to the year end, the Company sold undeveloped property for proceeds of $128,000.

Amortization of office equipment is provided using the declining balance method at an annual rate of 20%.

Amortization of the office condominium is provided using the declining balance method at an annual rate of 4%.

Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, the change in the future tax asset and liability is to be included in income. Future tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

The balance of future income taxes at December 31, 2002 consists mainly of the net book value of capital assets in excess of the undepreciated capital cost and unused resource deductions, which arise from the difference between the Company's amortization and depletion rates and those prescribed for income tax purposes, and the future site restoration costs that have been expensed for accounting purposes but are only deductible for tax purposes in the year incurred.

Site restoration

Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

Earnings per share

Basic earnings (loss) per common share are calculated using the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share are presented using the treasury stock method and are calculated by dividing net earnings (loss) applicable to common shares by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued.

5. CAPITAL ASSETS

	Cost	2002 Accumulated Amortization	Net
Office equipment	$ 26,514	$ 8,867	$ 17,647
Producing petroleum and natural gas properties and related equipment	1,426,710	700,936	725,774
Non-producing petroleum and natural gas properties	1,005,565	–	1,005,565
Office condominium	196,538	11,635	184,903
	$ 2,655,327	$ 721,438	$ 1,933,889

	Cost	2001 Accumulated Amortization	Net
Office equipment	$ 23,825	$ 4,791	$ 19,034
Producing petroleum and natural gas properties and related equipment	1,585,702	602,963	982,739
Non-producing petroleum and natural gas properties	390,780	–	390,780
Office condominium	196,538	3,931	192,607
	$ 2,196,845	$ 611,685	$ 1,585,160

6. BANK INDEBTEDNESS

The bank credit facility allows for a $250,000 operating line available by way of account overdraft to assist with the acquisition and development of oil and gas reserves. The operating line bears interest at the bank's prime rate plus 1% and is secured as disclosed in Note 7.

7. BANK LOANS

	2002	2001
Office condo mortgage, repayable in monthly payments of $1,667 plus interest at prime plus 1%, due May 31, 2006	$ 68,327	$ 88,331
Production loan, repayable in monthly payments of $12,657 plus interest at prime plus 1%, due November 30, 2003	139,200	291,084
	$ 207,527	$ 379,415

Estimated principal repayments are as follows:

2003	$ 159,204
2004	20,004
2005	20,004
2006	8,315
	$ 207,527

Collateral lodged by the Company to support the bank credit facilities is as follows:

(i) a debenture and general security agreement with a fixed and floating charge over all assets;

(ii) an assignment of all risk insurance proceeds;

(iii) environmental indemnity.

8. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares

Unlimited number of first preferred non-voting shares

b) Issued

	2002		2001	
	Issued	Amount	Issued	Amount
Balance at beginning	4,837,863	$ 856,711	4,837,863	$ 856,711
Options exercised	350,000	70,000	–	–
Shares issued pursuant to a private placement, net of share issuance costs	870,000	432,090	–	–
	6,057,863	$ 1,358,801	4,837,863	$ 856,711

On June 4, 2002 the Board of Directors approved a Private Placement of up to 1,000,000 shares of the Companyat $0.50 each. The minimum block available for purchase was set at 50,000 shares or $25,000 and in order to comply with regulatory guidelines for expedited Private Placements, at least 50% of the shares issued had to be purchased by arm's length parties. The Private Placement was closed September 20, 2002 with $435,000 raised through the issue of 870,000 common shares which have a 12 month hold period.

c) Stock options

The Company adopted a stock option plan in May 1997 in order to assist in attracting, retaining and motivating directors, officers, key employees and consultants of the Company. Under the plan a maximum amount equal to 10% of the issued and outstanding common shares of the Company may be reserved for issuance pursuant to stock options provided that no individual could be granted options in excess of 5% of the outstanding common shares of the Company. The Board of Directors determines the exercise price of the optioned shares however, that price cannot be less than the closing market price of the common shares of the Company on the trading day immediately prior to the grant less the maximum discount permitted by regulation. All options have a maximum expiry date of the fifth anniversary of the grant date.

A summary of the Company's director, officer and key employee share options at December 31, 2002 and 2001 and the changes for the years ending on those dates is presented below:

	2002		2001	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance at beginning of year	450,000	0.21	350,000	0.20
Granted	400,000	0.60	100,000	0.25
Exercised	(350,000)	0.20	–	–
	500,000	0.53	450,000	0.21

The following table summarizes information about the options outstanding at December 31, 2002.

Options outstanding	Exercise price	Options exercisable at Dec. 31, 2002	Expiry date
100,000	$ 0.25	100,000	March 15, 2006
400,000	0.60	–	June 4, 2007
500,000		100,000	

The options granted during the year will vest on June 4, 2003.

d) Stock-based compensation costs

The following pro forma information shows the impact that adopting the fair value method for stock based compensation costs related to the awards of options to directors, officers and employees would have had on the Company's loss and loss per share. The fair value of the options has been calculated using the Black-Scholes model using the assumptions outlined on the following.

		2002
Stock based compensation costs	$	132,117
Net loss attributable to common shareholders – as reported	$	(91,934)
Net loss attributed to common shareholders – pro forma	$	(229,041)
Net loss per common share – as reported	$	(0.02)
Net loss per common share – pro forma	$	(0.04)
Fair value of options granted per common share	$	0.57
Expected life (years)		5.0
Risk free interest rate		2.9%
Expected volatility		174%

The expected dividend yield rate is 0%.

There were no stock options issued to non-employees.

9. RELATED PARTY TRANSACTIONS

Included in general and administrative expense are consulting fees of $184,881 (2001 – $110,000) paid to companies controlled by officers and directors of the Company. Accounts payable includes $12,840 (2001 – $29,425) payable to these companies for consulting fees. The fees were paid in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

10. FUTURE INCOME TAXES

a) The components of future income tax balances are as follows:

		2002		2001
Capital assets	$	163,756	$	217,091
Share issue costs		(1,473)		(4,938)
Site restoration		(29,218)		(23,088)
	$	133,065	$	189,065

b) The provision for income taxes recorded in the financial statements differs from the amount which would be obtained by applying the statutory income tax rate of 42.1% (2001 – 42.1%) to the earnings (loss) for the years as follows:

		2002		2001
Earnings (loss) for the year before income taxes	$	(122,995)	$	156,527
Anticipated income tax expense (recovery)	$	(52,000)	$	66,000
Non-deductible crown charge and other payments		49,278		108,314
Federal resource allowance		(11,285)		(64,863)
Alberta Royalty Tax Credit		(2,222)		(5,378)
Change in income tax rates		–		(16,621)
Other		(14,832)		(11,863)
Income tax expense (recovery)	$	(31,061)	$	75,589

At December 31, 2002 the Company had an undepreciated capital cost balance of $248,000, Canadian oil and gas property expense of $272,000 and Canadian development expense of $20,000 available to apply against future years' taxable income.

11. EARNINGS PER SHARE

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated to reflect the dilutive effect of stock options outstanding. Earnings per share is calculated as follows:

			2002		
		Net Earnings (loss)	Shares		Earnings per share
Basic and diluted	$	(91,934)	5,314,320	$	(0.02)

			2001		
		Net Earnings (loss)	Shares		Earnings per share
Basic	$	80,938	4,837,863	$	0.02
Dilutive effect of options		–	16,667		–
Diluted	$	80,938	4,854,530	$	0.02

In the current year, options to purchase shares (see Note 8c) were not included in the computation of diluted earnings per share as they would be anti-dilutive. In 2001, options to purchase 100,000 common shares at $0.25 per share were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price of the common shares.

12. COMMITMENTS

On March 10, 2001 the Company executed a Joint Operating Agreement on a service contract for the Masjed-I-Suleyman (MIS) oil field in Iran. All necessary government approvals on the service contract terms and conditions were received February 12, 2002. Formal signings of the MIS Service Contract occurred on May 28, 2002. Sheer Energy (Cyprus) Limited is the operator of the project and holds a 49% interest. The terms of the agreement call for total expenditures relating to the project of US$81.0 million by Sheer Energy (Cyprus) Limited and its partner Naftgaran Engineering Services Company of Tehran (51%) over a period of four years. Repayment will be made from crude oil sales over three years following the project completion. The Company is currently negogiating financing for its share of capital costs.

13. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of accounts receivable, accounts payable, bank indebtedness and bank loans.

Credit Risk

Credit risk arises from the possibility that the entities to which the Company sells its oil and gas production to may experience difficulty and be unable to fulfill their obligations. The Company is exposed to financial risk that arises from the credit quality of the entities to which it provides services. However, due to the credit quality of the entities to which the Company sells to, credit risk and credit risk concentration is minimized.

Interest Rate Risk

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to financial risk that arises from the interest rate differentials between the market interest rate and the rates used on their financial instruments.

The bank indebtedness and bank loans bear a variable interest rate of prime plus 1%. The effective interest rate realized during the year was 4.9% (2001 – 5.7%). The average interest rate was 5.1% (2001 – 6.8%).

Foreign Exchange Rate Fluctuation

The Company is exposed to foreign currency fluctuation in relation to its wholly owned subsidiary Sheer Energy (Cyprus) Limited. Management believes this exposure is not material to its overall operations.

14. SEGMENTED INFORMATION

The Company's business activities are undertaken in Canada and the Middle East. The accounting policies followed by the Canadian segment are also followed by the Middle East segment.

	Canada	Middle East	2002
Revenue	$ 653,806	$ -	$ 653,806
Operating expenses	(757,838)	(18,963)	(776,801)
Operating loss	$ (104,032)	$ (18,963)	$ (122,995)

	Canada	Middle East	2001
Revenue	$ 1,042,812	$ -	$ 1,042,812
Operating expenses	(879,286)	(6,999)	(886,285)
Operating income (loss)	$ 163,526	$ (6,999)	$ 156,527

Identifiable assets	2002	2001
Canada	$ 877,200	$ 1,083,173
Middle East	1,529,929	405,540
	$ 2,407,129	$ 1,488,713

Corporate assets	2002	2001
Canada	$ 202,550	$ 211,641

Total assets	2002	2001
Canada	$ 1,079,750	$ 1,280,054
Middle East	1,504,479	405,540
	$ 2,584,229	$ 1,685,594

CORPORATE INFORMATION

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